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SUBJECT: POST RECOMMENDS AGAINST DOWNGRADE OF ICRAS RISK RATING FOR PAKISTAN

11. (SBU) Post urges the Interagency Credit Risk Assessment System committee not to downgrade Pakistan's sovereign and non-sovereign risk rating on March 23. The draft report, dated January 1, does not reflect the progress and the commitment the GOP has made to bring its economic house in order, as well as the stabilizing effect the IMF program has had on investor confidence. Furthermore, political tensions with India have calmed in the aftermath of the Mumbai attacks, in large part because the GOP has arrested the likely masterminds of the attack. There have been both gains and losses in the fight against extremists; domestically, the GOP has promised to resolve the judges' issue, a major bone of contention with the political opposition. Now is not the time to derail the GOP's positive track record on stabilizing the economy, in particular with the Donors' Conference coming up next month. End Summary.

12. (SBU) We understand that on March 23 the Interagency Credit Risk Assessment System committee will review Pakistan's sovereign and credit risks. The draft report recommends that both the sovereign and non-sovereign debt of Pakistan be downgraded from "E" to "E minus". Post strongly supports leaving Pakistan's credit ratings unchanged at this time. Many of the statements in the draft report do not reflect the stabilization that has occurred in the economy recently. Over the past four months, since the IMF Stand-By Arrangement was signed, the GOP has successfully met all its first quarter targets and impressed IMF officials with its commitment to stabilize the economy (reftel). The exchange rate has remained stable, and Pakistan's international reserves have strengthened significantly (\$6.61 billion as of March 6, up from a low of \$3 billion in fall 2008). Pakistan is current on its debt obligations, and has recently made a \$517 million Eurobond payment. The ICRAS prediction that GOP borrowing from the central bank will increase is not borne out by the GOP's current actions of retiring debt to the State Bank of Pakistan.

13. (SBU) While both the IMF and the GOP recognize that the revenue targets are optimistic, given the slowing economy, the GOP has indicated that it wishes to maintain these targets, and has committed to reduce spending if necessary to maintain the deficit target. Pakistan has recently received large amounts of foreign inflows - a \$500 million World Bank tranche will be paid this month,

and \$500 million from the Islamic Development Bank. Another \$500 million from the Asian Development Bank is expected before end-June.

Japan and the World Bank are hosting a donors' conference in mid April and indications are that it will be successful in securing substantial new financing.

¶4. (SBU) While the ICRAS report states that remittances and exports are declining, statistics as of the end of February show remittances up by 19 percent, and exports are up by 5.4 percent. Interest rates are declining (KIBOR has fallen more than three percent in the last month), and the fiscal deficit has fallen to 1.9 percent during the July-December 2008 period (the report cites a 7.4 percent deficit for the year ending June 2008).

¶5. (SBU) In post's opinion, the political risk section of the ICRAS report greatly overstates the danger of a war between India and Pakistan. In the wake of the Mumbai tragedy, both governments have acted in a restrained manner, and Pakistan willingness to arrest those accountable has defused tensions. There have been both gains (in Bajaur) and losses (in Swat) in the GOP's battle against extremism. Domestically, the government has agreed to restore the deposed judiciary, an issue that had created significant friction with civil society and the political opposition. Obviously, political difficulties will persist, but we would argue that they are not such as to warrant a further downgrade.

PATTERSON